

GENERAL FUND REVENUE UPDATE JUNE 2003

A Report Prepared for the
Legislative Finance Committee
and the
**Revenue and Transportation
Interim Committee**

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INTRODUCTION

The purpose of this report is to provide the committees with a summary of to date general fund revenue collections for fiscal 2003. The report also outlines some of the significant economic trends that may indicate the general fund revenue outlook for the 2005 biennium. This report is based on information extracted from the Statewide Accounting, Budgeting, and Human Resources system (SABHRS) through June 19, 2003.

This report is organized in three relevant sections. The first section discusses fiscal 2003 general fund revenue trends. Section 2 provides a summarization of significant economic indicators for both the state and national economies. Section 3 discusses the personal property tax rate trigger that may impact state and local revenues for the 2005 biennium and subsequent biennia.

FISCAL 2003 TO DATE COLLECTIONS

Based on information recorded through June 19, 2003, on SABHRS, total general fund receipts for fiscal 2003 were \$1,014.3 million as shown in Figure 1. This compares to \$1,265.7 million collected for all of fiscal 2002. At this point in time, total general fund collections are \$251.4 million below last year's amount, which represents a 19.9 percent decrease. This trend by itself indicates that general fund revenue growth is well below expectations since total revenues (per HJR 2 revenue estimate resolution) are expected to decrease by \$43.0 million from fiscal 2002 actual amounts. However, there are various factors that refute this simplistic approach to assessing the current general fund revenue condition.

Under the old accounting system (SBAS), there were 13 separate months of data recorded in a fiscal year. Each month of data (July through June) was maintained plus a separate "month" for final fiscal year-end adjustments. SABHRS maintains data by month but the June data reflects not only collections for the month of June but also includes fiscal year-end adjustments. Fiscal year-end adjustments include revenues received after June 30th payable for the previous fiscal year and any revenue accruals. Several of the general fund revenue collections will include an accrual component once the fiscal year is complete.

Since June collections for fiscal 2002 includes fiscal year-end adjustments, comparing collections during June of this year with last year can be very misleading especially for those sources of revenue that will contain an accrual component. Nonetheless, Figure 1 does provide an insight into the magnitude of revenue activity that occurs between mid June and final closeout for the fiscal year. Fiscal year-end closeout for fiscal 2003 will be concluded by late July.

Changes in general economic conditions can also skew aggregate growth trends especially when the change occurs gradually throughout the year. During fiscal 2003, several economic assumptions adopted by the 58th Legislature showed progressive weakening. Although the revenues associated with these economic assumptions may have appeared to be within forecasts early in the fiscal year, actual collections in the later part of the year showed signs of slower growth. This is due to the time lag between the impacts of economic changes and when tax revenues are actually received.

<p align="center">Figure 1 General Fund Revenue Status</p>						
Revenue Source	Estimated Fiscal 2003	Through Fiscal End 2002	Through 6/19/03	Difference	% Change	HJR2 Estimated % Change
GF0100 Drivers License Fee	2,355,000	2,580,000.06	1,982,989.19	(597,010.87)	-23.1400%	-8.7209%
GF0200 Insurance Tax	51,446,000	47,290,737.87	35,406,381.84	(11,884,356.03)	-25.1304%	8.7866%
GF0300 Investment Licenses	4,567,000	4,991,592.83	4,876,321.70	(115,271.13)	-2.3093%	-8.5062%
GF0400 Vehicle License Fee	74,773,000	73,127,443.90	62,266,771.77	(10,860,672.13)	-14.8517%	2.2503%
GF0500 Vehicle Registration Fee	27,703,000	27,271,180.46	23,357,748.32	(3,913,432.14)	-14.3501%	1.5834%
GF0600 Nursing Facilities Fee	5,723,000	5,918,173.00	4,349,767.87	(1,568,405.13)	-26.5015%	-3.2979%
GF0700 Beer Tax	2,918,000	2,783,902.92	2,515,380.93	(268,521.99)	-9.6455%	4.8169%
GF0800 Cigarette Tax	12,408,000	7,886,902.50	9,483,322.79	1,596,420.29	20.2414%	57.3241%
GF0900 Coal Severance Tax	10,221,000	8,469,403.65	7,493,224.48	(976,179.17)	-11.5259%	20.6815%
GF1000 Corporation Tax	47,347,000	68,173,253.00	36,051,112.89	(32,122,140.11)	-47.1184%	-30.5490%
GF1100 Electrical Energy Tax	4,329,000	4,197,476.68	3,129,910.34	(1,067,566.34)	-25.4335%	3.1334%
GF1150 Wholesale Energy Trans Tax	3,373,000	2,906,262.84	2,650,227.49	(256,035.35)	-8.8098%	16.0597%
GF1200 Railroad Car Tax	1,577,000	1,489,812.65	1,449,493.80	(40,318.85)	-2.7063%	5.8522%
GF1300 Individual Income Tax	520,764,000	517,567,691.00	493,679,852.33	(23,887,838.67)	-4.6154%	0.6176%
GF1400 Inheritance Tax	11,015,000	13,816,144.00	11,520,745.15	(2,295,398.85)	-16.6139%	-20.2744%
GF1500 Metal Mines Tax	4,842,000	3,329,340.36	3,057,556.48	(271,783.88)	-8.1633%	45.4342%
GF1600 Natural Gas Severance Tax	-	-	-	-	-	-
GF1700 Oil Severance Tax	21,676,000	12,902,438.76	8,763,674.61	(4,138,764.15)	-32.0774%	67.9992%
GF1800 Public Contractor's Tax	2,679,000	3,267,321.18	2,653,144.01	(614,177.17)	-18.7976%	-18.0062%
GF1900 1.5 VoTech Levy	881,000	918,612.28	534,957.55	(383,654.73)	-41.7646%	-4.0945%
GF2000 40 Statewide Levy	62,472,000	63,044,974.91	42,696,646.17	(20,348,328.74)	-32.2759%	-0.9088%
GF2100 55 Statewide Levy	106,865,000	105,375,801.12	69,405,774.81	(35,970,026.31)	-34.1350%	1.4132%
GF2200 Telephone Tax	33,000	212,301.46	33,498.02	(178,803.44)	-84.2215%	-84.4561%
GF2250 Retail Telecom Excise Tax	20,100,000	19,593,500.71	15,748,077.57	(3,845,423.14)	-19.6260%	2.5850%
GF2251 Retail Telecom Excise Tax	-	-	-	-	-	-
GF2300 Tobacco Tax	2,399,000	2,182,826.91	1,975,095.01	(207,731.90)	-9.5166%	9.9034%
GF2400 Video Gaming Tax	45,219,000	43,666,144.95	34,069,817.29	(9,596,327.66)	-21.9766%	3.5562%
GF2500 Wine Tax	1,264,000	1,231,861.82	1,233,834.69	1,972.87	0.1602%	2.6089%
GF2600 Institution Reimbursements	15,851,000	14,282,893.56	10,777,158.02	(3,505,735.54)	-24.5450%	10.9789%
GF2650 Highway Patrol Fines	4,142,000	4,061,732.87	3,515,392.71	(546,340.16)	-13.4509%	1.9762%
GF2700 TCA Interest Earnings	7,456,000	12,414,382.00	5,915,014.20	(6,499,367.80)	-52.3535%	-39.9406%
GF2800 Local Impact Interest	-	-	-	-	-	-
GF2900 Liquor Excise Tax	9,854,000	9,513,531.41	9,167,088.38	(346,443.03)	-3.6416%	3.5788%
GF3000 Liquor Profits	5,637,000	5,600,000.00	-	(5,600,000.00)	-100.0000%	0.6607%
GF3100 Coal Trust Interest Earnings	36,825,000	37,605,247.22	30,149,713.07	(7,455,534.15)	-19.8258%	-2.0748%
GF3200 Interest & Income	-	48,937,672.66	-	(48,937,672.66)	-100.0000%	-100.0000%
GF3300 Lottery Profits	6,210,000	7,467,030.00	3,735,586.00	(3,731,444.00)	-49.9723%	-16.8344%
GF3400 Long Range Bond Excess	-	-	-	-	-	-
GF3450 Tobacco Settlement	19,025,000	18,647,411.00	18,486,670.00	(160,741.00)	-0.8620%	2.0249%
GF3500 U.S. Mineral Leasing	22,715,000	19,772,193.46	19,750,737.79	(21,455.67)	-0.1085%	14.8836%
GF3600 Other Revenue	46,059,000	43,215,892.00	32,413,359.16	(10,802,532.84)	-24.9967%	6.5788%
Grand Total	1,222,723,000	1,265,713,088.00	1,014,296,046.43	(251,417,041.57)	-19.8637%	-3.3965%

Although collection data through June 19th would indicate the potential for a serious fiscal crisis, further research and analysis by our office portrays a more realistic picture of total collections for fiscal 2003. It should be noted that our analysis does not include any impacts of the federal "Jobs and Growth Tax Relief Reconciliation Act" or the receipt of the federal flexible grant monies.

As shown in Figure 2, there are five sources of revenue that are significantly different than the amount estimated in HJR 2. The impact of these differences is a negative \$4.3 million for fiscal 2003. This estimate was based on a review of to date revenue collections for each general fund revenue source and, if applicable, conversations with appropriate agency representatives.

The grand total shown in Figure 2 is \$6.7 million. Included in this amount is the excess U.S. mineral royalty revenue above the threshold amount of \$21.7 million. House Bill 11, as adopted by the August 2002 Special Legislative session, amended the original threshold amount adopted in House Bill 226 of

<p align="center">Figure 2 Anticipated Excess/Deficit For Fiscal 2003 In Millions</p>	
Insurance Tax	(\$6.363)
Corporation Tax	(2.699)
Individual Income Tax	2.963
TCA Interest Earnings	(0.840)
U.S. Mineral Royalty	2.417
All Other	0.199
Sub-Total	(\$4.323)
U.S. Mineral Royalty - County Payment	(2.417)
Grand Total	(\$6.740)

the 2001 legislative session. This legislation requires revenues from U.S. mineral royalties in excess of \$21.671 million received in fiscal 2003 to be distributed to eligible counties. It is estimated the excess above the threshold will be \$3.5 million. However, since the 58th Legislature assumed the excess would be \$1.1 million, the net excess is \$2.4 million. The distribution of the excess revenues will be done with a statutory appropriation from the general fund.

The following section of the report discusses collection detail for the revenue sources listed in Figure 2.

Insurance Tax

Based on preliminary information from the State Auditor and collection data from SABHRS, insurance tax revenue collections are expected to be \$6.4 million below HJR 2 estimates for fiscal 2003. Our current research has not determined the cause for the downturn in revenues from this source. Conversations with staff from the State Auditor suggest that the office might have an internal tax allocation problem that needs to be resolved. While this accounting problem may explain some of the shortfall, further research is required to fully understand all of the circumstances behind the shortfall.

Corporation Income Tax

As shown in Figure 3, total corporation income taxes through June 19th of fiscal 2003 are \$32.1 million below collections as compared to all of fiscal 2002. As Figure 3 indicates, current year and estimated payments are significantly below last year's amount while refunds issued are up significantly. Audit collections are higher than last year's amount.

The 58th Legislature assumed that corporation income tax revenues would decline from \$68.2 million in fiscal 2002 to \$47.3 million in fiscal 2003. This represents a \$20.9 million decline or 30.6 percent. Obviously, if the trend portrayed in Figure 3 would prevail for the remainder of fiscal 2003, the corporation income tax estimate adopted by the 58th Legislature would not materialize. Since estimated payments were due on June 15th, June 19th SABHRS information does not include all of these collections. Based on our analysis of previous estimated payments, corporation tax revenues are expected to be about \$2.7 million below the HJR 2 estimate for fiscal 2003.

Individual Income Tax

As shown in Figure 4, total individual income taxes through June 19th of fiscal 2003 are \$23.9 million below collections as compared to all of fiscal 2002. As Figure 4 indicates, withholding, estimated, and current year payments are below last year's amount. Interestingly, refunds are also below last year's amount, which is a reversal of the trend that was observed during previous months. Audit collections are higher than last year's amount.

Figure 3 Corporation Income Tax Comparison				
Revenue Code & Description	Through FYE Fiscal 2002	Through 06/19/03 Fiscal 2003	Difference	Percent Change
510501 Corporation Tax	31,878,723.23	16,539,228.60	(15,339,494.63)	-48.12%
510505 Corporation Tax Estimated Paym	46,985,582.44	39,422,728.79	(7,562,853.65)	-16.10%
510503 Corporation Tax-Audit Collect.	5,915,903.00	7,811,976.00	1,896,073.00	32.05%
510502 Corporation Tax Refunds	(16,606,955.27)	(27,722,820.50)	(11,115,865.23)	66.93%
Totals	\$68,173,253.40	\$36,051,112.89	(\$32,122,140.51)	-47.12%
Percent of Actual/Estimated	100.00%	76.14%		
Potential Shortfall for Fiscal 2003		(\$2,699,000)		
HJR2 Estimate		\$47,347,000		-30.55%

The 58th Legislature assumed that individual income tax revenues would increase from \$517.6 million in fiscal 2002 to \$520.8 million in fiscal 2003. This represents a \$3.2 million increase or 0.6 percent. If the trend portrayed in Figure 4 would prevail for the remainder of fiscal 2003, the individual income tax estimate adopted by the 58th Legislature would not materialize. Since estimated payments were due on June 15th, the June 19th SABHRS information does not include all of these collections. Based on our analysis of previous estimated payments and withholding trends, individual income tax revenues are expected to be about \$3.0 million above the HJR 2 estimate for fiscal 2003.

Figure 4				
Individual Income Tax Comparison				
Revenue Code & Description	Through FYE Fiscal 2002	Through 06/19/03 Fiscal 2003	Difference	Percent Change
510101 Withholding Tax	418,349,407.37	410,693,922.41	(7,655,484.96)	-1.83%
510102 Estimated Tax	140,025,136.27	130,921,785.76	(9,103,350.51)	-6.50%
510103 Current Year I/T	92,127,859.95	80,413,900.64	(11,713,959.31)	-12.71%
510105 Income Tax - Audit Collections	21,812,030.74	22,573,594.00	761,563.26	3.49%
510106 Income Tax Refunds	(154,746,743.03)	(150,923,350.48)	3,823,392.55	-2.47%
Totals	\$517,567,691.30	\$493,679,852.33	(\$23,887,838.97)	-4.62%
Percent of Actual/Estimated	100.00%	94.80%		
Potential Excess for Fiscal 2003		\$2,963,000		
HJR2 Estimate		\$520,764,000		0.62%

Treasury Cash Interest

Treasury cash interest earnings are revenues received from the investment of idle cash that is available on a daily basis. Unless specifically stated by statute, all earnings on these investments are deposited in the general fund. Since these investments are primarily in short-term instruments, revenue collections are extremely sensitive to prevailing short-term interest rates. Since the Federal Reserve Board (FED) has reduced interest rates to historic lows, investment revenue from this source is expected to be \$0.8 million below the HJR 2 revenue estimate.

U.S. Mineral Royalty

At this point in time, it is not totally clear why revenues from this source are exceeding expectations. A majority of the revenue from this source is derived from coal, oil, and natural gas production on federal lands. While total production of coal on federal lands is the primary revenue variable, oil and natural gas prices are also significant indicators. Data from the federal Minerals Management Service, which will be available later this year, should assist in explaining the increased collections.

As mentioned earlier, U.S. mineral royalty revenue above the threshold amount of \$21.7 million is returned to eligible counties. House Bill 11, as adopted by the August 2002 Special Legislative session, amended the original threshold amount adopted in House Bill 226 of the 2001 legislative session. This legislation requires revenues from U.S. mineral royalties in excess of \$21.671 million received in fiscal 2003 to be distributed to eligible counties. It is estimated the excess above the threshold will be \$3.5 million. However, since the 58th Legislature assumed the excess would be \$1.1 million, the net excess is \$2.4 million. The distribution of the excess revenues will be done with a statutory appropriation from the general fund.

SIGNIFICANT ECONOMIC TRENDS

Since adjournment of the legislature, there have been numerous articles that depict the status of various state and national economic indicators. While Montana's economy is doing well, considering increased income and employment levels, it should be noted that state government revenues are not totally driven by these factors. Montana revenues are extremely sensitive to many other factors such as corporate profitability, prevailing interest rates, capital gains/losses, energy prices, and federal tax changes. The following is a brief summary of relevant articles that may illustrate the vulnerability of the state and national economies. Many economists are cautious about the national economic outlook.

The Montana Economy

- Wage and salary growth still strong (April 2003). In the April 2003 Montana Economy at a Glance, the Department of Labor and Industry (DLI) note that average weekly earnings in Montana's private production sector were up 4.3 percent over the year in April. This exceeds U.S. inflation for this period of 2.2 percent by 2.1 percent.
- Non-farm employment increases from April 2002 (April 2003). According to the DLI, nonagricultural payroll employment was up 2,100 jobs, an increase of 0.5 percent, over the year in April. Increases were observed in the construction, professional & business services, leisure & hospitality, and private education & health services sectors.

The National Economy

- Consumer prices held in check (June 17, 2003). A recent report by CNN tells that the consumer price index, a broad measure of retail prices, showed no change in May compared with a decrease of 0.03 percent in April. The "core-CPI" which excludes food and energy prices posted a 0.3 percent increase, greater than the expected 0.1 percent. Energy prices were down 3.1 percent, and petroleum-based fuel prices fell 6.7 percent. Food prices offset the energy and gas price decreases with a 0.4 percent increase.
- Fed gives the economy a D (June 11, 2003). The Federal Reserve gave the U.S. economy performance in April a barely-passing grade, fueling speculation of another 0.25 to 0.50 percent cut in the discount rate at the June 24 meeting. CNN quotes the Fed report as saying, "The unwinding of war-related concerns appears to have provided some lift to business and consumer confidence, but most reports suggested that the effect has not been dramatic." The report notes "lackluster" consumer spending, mixed manufacturing activity, a "sluggish" service sector, and most importantly, continued labor market weakness as reason for the economy's poor grade.
- Continuing rally of the equity markets (June 13, 2003). Andy Kish at the *Dismal Scientist* believes the three-month rally of the equities market is a sign of the "durability of investor optimism." Since the low in mid March increases include: the Dow at 18 percent; the S&P at 25 percent; and the NASDAQ at 30 percent. However, investor confidence will face challenges in the coming weeks with news of interest rate changes, second quarter corporate earnings, and labor market growth.
- Consumer confidence edges up in May (May 27, 2003). Consumer confidence posted a moderate increase in May after increasing sharply in April. The May index stands at 83.8, up from 81.0 in April. According to Lynn Franco, Director of The Conference Board's Consumer Research Center, consumers have redirected their view of "post-war euphoria" to matters of the home front. "Labor market conditions continue to be of concern, but consumers anticipate a turnaround in the coming months."

PERSONAL PROPERTY TAX RATE TRIGGER

Under current law, Title 15-5-138, MCA, personal property tax rates are automatically reduced from three percent to zero if the real growth rate (inflation adjusted) in Montana's wage and salary income exceeds 2.85 percent. If the trigger is met, the reduced tax rates are phased-out over a three-year period.

As defined in statute, wage and salary income is as reported by the federal Bureau of Economic Analysis (BEA) and inflation is as reported by the federal Bureau of Labor Statistics (BLS). Based on preliminary quarterly data for wage and salary income from the BEA for calendar 2001 and 2002, and actual inflation data from the BLS for calendar 2001 and 2002, the real wage and salary income growth is calculated to be 3.34 percent, well above the 2.85 percent trigger contained in statute. The statute specifically defines the calendar years to be used in the calculations for tax year 2005. This means that beginning in tax year 2005, personal property tax rates would be phased-out over a three-year period.

Figure 5 summarizes the estimated impact to state and local government if the trigger is achieved. Beginning in fiscal 2005, the estimated impact for all entities of government would be \$9.0 million. For

Figure 5 Personal Property Tax Rate Reduction Impacts In Millions				
Fiscal Year	General Fund	University System	Local Government	Total
2005	(\$1.790)	(\$0.112)	(\$7.068)	(\$8.970)
2006	(6.304)	(0.395)	(24.893)	(31.592)
2007	(10.604)	(0.665)	(41.873)	(53.142)
2008	(13.550)	(0.850)	(53.508)	(67.908)

the 2007 biennium, the reduction in revenues for all governments is estimated to be \$84.7 million. The state general fund impact would be approximately \$16.9 million during the 2007 biennium. For each year after fiscal 2007, the total estimated impact would be about \$67.9 million per year or about \$13.6 million state general fund impact.

Since the official wage and salary income data will not be available until late September, there is the possibility that there may be some revisions to the data between now and September. If the changes are minimal, the 59th Legislature will be faced with a significant fiscal issue that will impact local government (including public schools) as well as state government.

SUMMARY

Based on SABHRS information as of June 19th and conversations with appropriate agency representatives, total general fund revenues are expected to be below the HJR 2 revenue estimate for fiscal 2003 by \$4.3 million. Since any excess U.S. mineral royalty revenue is to be returned to eligible counties, the total fund balance reduction is estimated to be about \$6.7 million.

The projected ending general fund balance for fiscal 2003 would be reduced from \$16.5 million to \$9.8 million assuming all appropriations and transfers are expended as budgeted. Since the executive has indicated they may transfer protested tax payments to the general fund in fiscal 2003, this reduction may be mitigated. Senate Bill 294, passed by the 58th Legislature, authorizes the transfer of protested taxes on centrally assessed property from the local protest fund to the state general fund. The bill was effective on passage and approval. The legislature assumed the transfers would occur in the 2005 biennium.

Montana's economy continues to show strength when measured by income growth. However, Montana's revenues are extremely sensitive to many other factors such as corporate profitability, prevailing interest rates, capital gains/losses, energy prices, and federal tax changes. If the FED reduces interest rates further, as speculated by many economists, reduced investment earnings and individual income taxes would impact state general fund revenue collections. In the longer-term, reduced interest rates should eventually stimulate economic growth.

The potential for the phase-out of the personal property tax rate from three percent to zero has a high probability. While the state fiscal impact in the 2005 biennium would be relative small, the impacts of the phase-out in subsequent biennia would be substantial. The 59th Legislature would be faced with a significant fiscal issue that would impact local government (including public schools) as well as state government.